

09-2968  
AUDIT  
05-25-2010

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BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER 1 & PETITIONER 2,  Petitioners,  v.  AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,  Respondent.	<b>INITIAL HEARING ORDER</b>  Appeal No. 09-2968  Account No. ##### Tax Type: Income Tax Tax Year: 2006  Judge: Phan
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**Presiding:**

Jane Phan, Administrative Law Judge

**Appearances:**

For Petitioner: PETITIONER 1  
For Respondent: RESPONDENT REP. 1, Assistant Attorney General  
RESPONDENT REP. 2, Income Tax Auditing

**STATEMENT OF THE CASE**

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Sec. 59-1-502.5, on April 15, 2010. Petitioners (the Taxpayers) are appealing an audit deficiency of Utah individual income tax for the year 2006. The Statutory Notice of Deficiency and Audit Change had been issued on September 2, 2009. The amount of the audit deficiency listed on the statutory notice at issue is as follows:

	Tax	Penalty	Interest	Total as of Notice Date <sup>1</sup>
2006	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

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1. Interest continues to accrue on the unpaid balance.

APPLICABLE LAW

State taxable income is defined in Utah Code Ann. §59-10-112 (2006)<sup>2</sup> as follows:

"State taxable income" in the case of a resident individual means his federal taxable income (as defined by Section 59-10-111) with the modifications, subtractions, and adjustments provided in Section 59-10-114 . . .

For the year at issue, Utah Code Ann. §59-10-102 (2006) provided the intent of the Legislature in enacting the Utah Individual Income Tax Act, as follows in pertinent part:

The intent of the Legislature in the enactment of this chapter is to accomplish the following objectives:

(1) to impose on each resident individual, estate, or trust for each taxable year a tax measured by the amount of his "taxable income" for such year, as determined for federal income tax purposes, subject to certain adjustments; and

. . . .

(3) to adopt for Utah individual income tax purposes, by reference, the provisions of the federal income tax laws which are applicable in arriving at the amount of income subject to tax for federal income tax purposes which, it is believed, will:

(a) promote consistency in tax treatment of persons required to file returns of income for both federal individual income tax and Utah individual income tax purposes;

. . . .

Utah Code §59-10-115 (2006) provided for an equitable adjustment, under specified circumstances in pertinent part:

(1) The Commission shall allow an adjustment to state taxable income of a taxpayer if the taxpayer would otherwise: (a) receive a double tax benefit under this part; or (b) suffer a double tax detriment under this part.

. . .

The applicable statutes specifically provide that the taxpayer bears the burden of proof in proceedings before the Tax Commission. Utah Code Sec. 59-1-1417 provides:

In a proceeding before the commission, the burden of proof is on the petitioner. . .

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<sup>2</sup> The Utah Individual Income Tax Act has been revised and provisions renumbered subsequent to the audit period. The Commission cites to and applies the provisions that were in effect during the audit period on substantive legal issues.

### DISCUSSION

The facts in this case were not in dispute between the parties. The Taxpayer, PETITIONER 1, had begun to receive social security benefits in the year 2005 and received \$\$\$\$\$ in benefits that year. The Taxpayers claimed these benefits on their 2005 Utah and federal income tax returns for that year, of which \$\$\$\$\$ was included in their taxable income. They paid both state and federal income tax on this amount, clearly paying tax once to the state of Utah with their 2005 return on these 2005 social security benefits.

PETITIONER 1 also received social security benefits in 2006, but before the year's end he made a determination to voluntarily cancel his social security benefits. Once he canceled the benefits, he was required to repay in 2006 all the benefits that he had received both in 2005 and 2006. For the 2006 year, what he received and what he repaid equaled out so that he could claim \$\$\$\$\$ benefits for that year. For the 2006 tax year, the Social Security Administration issued to him a revised Form 1099 with a negative amount, - \$\$\$\$\$. This -\$\$\$\$\$ was for the amount he had repaid for the benefits he received in 2005.

Therefore, it was the 2005 income that was the problem. Since PETITIONER 1 had received the money in 2005, they had been required to claim it on their federal return for 2005, which then carried over to their Utah taxable income. When the Taxpayers originally filed their Utah and federal returns for 2006, they tried to adjust for the 2005 income by subtracting the taxable portion, which was \$\$\$\$\$, from their taxable income, thereby subtracting from their 2006 income the taxable amount of the benefits they had received in 2005, but repaid in 2006. The IRS later audited the Taxpayers' return and disallowed this adjustment. The Taxpayer represented that he was told by the IRS that he could either account for the \$\$\$\$\$ as an itemized deduction or claim a credit on their 2006 return under IRC1341. The Taxpayers chose the credit as it provided the largest benefit on their federal return. However, taking the credit meant they could not deduct the \$\$\$\$\$ from their taxable income for the 2006-year on the federal return.

The Taxpayer argued that he should be allowed to deduct the \$\$\$\$\$ as an equitable adjustment under Utah Code 59-10-115. He also argues that if he is required to pay the audit, he will be taxed twice on the same income. It was his position that he should have this treatment based on equitable reasons, to cancel out the tax he had paid in 2005 on money he had to pay back in 2006.

The Division's representative argued that the Taxpayer is not being taxed twice on the same income and further argued there is no basis to allow the equitable adjustment under Sec. 59-10-115. He pointed out that had the Taxpayer taken the amount of \$\$\$\$\$ as an itemized deduction on his federal return, the lower

federal adjusted gross income would have flowed through to the state return. However, there is no flow through when taken as a credit. The Division pointed out that the 2005 social security benefits had been included only one time in the Taxpayers' federal adjusted gross income and that had been in 2005. They had not been included in the Taxpayers 2006 FAGI, a fact that the Taxpayer acknowledged.

Upon review of the facts in this matter, although the \$\$\$\$ in Social Security Benefits was included in FAGI only once, and taxed only once, that being in 2005, the Taxpayers did repay the money in 2006, so are being taxed once on money that they were not able to retain. However, the Taxpayers are not being taxed twice on the \$\$\$\$ in Social Security Benefits. Even if they pay the audit deficiency this would not be a second tax on this \$. The Taxpayers argue it is not equitable to tax them on funds they had to repay. However, this situation is not one where the income was included for a second time for state income tax purposes. It does not qualify as an equitable adjustment under Utah Code Sec. 59-10-115.<sup>3</sup> Utah Code Sec. 59-10-112 specifically provides that state taxable income is federal taxable income with certain statutory modifications or adjustments. The Commission notes that the Taxpayers had an option under federal law to claim a deduction on their 2006 federal return. Had they done so it would have flowed through to the state return and they would have been able to deduct the income on their 2006 Utah return. The Taxpayers chose instead the other federal option, taking a credit under IRC1341 on their 2006 federal return. They chose this option because this gave them the biggest federal benefit.

Utah Code Sec. 59-10-102(4) provides that it was the legislative intent to provide laws that conform with the IRS. The Division's position in this matter is consistent with following the federal filing exactly. The provisions do not support that the Taxpayers may pick the one approach for the federal filing that gives them the biggest federal tax benefit, and another for their state tax filing that gives them the biggest state benefit. The tax treatment must be consistent with the federal and state filings. Therefore, the Taxpayers' appeal should be denied.

Jane Phan  
Administrative Law Judge

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<sup>3</sup> The facts in this appeal are dissimilar from those in *Tax Commission Appeal No. 09-2593*, where the Commission found there had been an inclusion in the Utah taxable income of income a second time and allowed that taxpayer to make an equitable adjustment. In this appeal the social security had only been included in the Taxpayers 2005 Utah taxable income. The Commission finds the facts in this case to be more similar to the number of appeals where the taxpayers requested an equitable adjustment for taxes paid to another country. In those cases the Commission routinely disallowed the equitable deduction. See *Tax Commission Appeal Nos. 05-1787 & 08-0590*.

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DECISION AND ORDER

Based upon the forgoing, the Commission denies the Taxpayers' appeal. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission  
Appeals Division  
210 North 1950 West  
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2010.

R. Bruce Johnson  
Commission Chair

Marc B. Johnson  
Commissioner

D'Arcy Dixon Pignanelli  
Commissioner

Michael J. Cragun  
Commissioner

**NOTICE:** If a Formal Hearing is not requested, failure to pay the balance due as determined by this order within thirty days of the date hereon, may result in a late payment penalty. Petitioner may contact Taxpayer Services at (801) 297-7703 to make payment arrangements.

*JKP/09-2968.int*